GLASS LEWIS

November 11, 2019
To: Israel Justice Ministry
29 Salah A-Din, Jerusalem, 9711052
Via email: NCScompanies@justice.gov.il

RE: **Public Consultation Regarding Adapting Corporate Governance Rules for Non-Controlled Companies**

Glass, Lewis & Co. ("Glass Lewis") appreciates the opportunity to comment as part of this public consultation on the matter of adapting corporate governance standards for a capital market with a greater number of non-controlled companies.

About Glass Lewis

Founded in 2003, Glass Lewis is a leading, independent governance services firm that provides proxy research and vote management services to more than 1,300 clients throughout the world. While, for the most part, institutional investor clients use Glass Lewis research to help them make proxy voting decisions, they also use Glass Lewis research when engaging with companies before and after shareholder meetings.

Through Glass Lewis' web-based vote management system, Viewpoint, Glass Lewis also provides investor clients with the means to receive, reconcile and vote ballots according to custom voting guidelines and recordkeep, audit, report and disclose their proxy votes.

From its offices in Europe, North America and Australia, Glass Lewis' 360+ person team provides research and voting services to institutional investors globally that collectively manage more than US$35 trillion. Glass Lewis is a portfolio company of the Ontario Teachers' Pension Plan Board ("OTPP") and Alberta Investment Management Corp. ("AIMCo"). Glass Lewis operates as an independent company separate from OTPP and AIMCo. Neither OTPP nor AIMCO is involved in the day-to-day management of Glass Lewis' business. Moreover, Glass Lewis excludes OTPP and AIMCo from any involvement in the formulation and implementation of its proxy voting policies and guidelines, and in the determination of voting recommendations for specific shareholder meetings.

The responses provided below are not meant to be exhaustive but are designed to address what Glass Lewis sees as the main issues in relation to the subject of the public consultation.

Glass Lewis Views on a Corporate Governance Framework Adapted to Companies without a Control Block

We start out from a position which considers Israel's Companies Law (the "Companies Law") to already offer a robust framework for protecting all shareholders' interests and specifically minority or dispersed shareholders. Furthermore, although certain legal procedures, such as

the Special Disinterested Majority (see below) shareholder vote, were designed to ensure the rights of minority shareholders to scrutinize sensitive issues, the absence of a dominant shareholder block does not, in our opinion, necessitate the removal of key shareholder checks on board decision-making.

Special Disinterested Majority ("Disinterested Majority") means the majority of the votes properly cast at a general meeting either in person, by proxy or by a voting instrument, provided that: (a) such majority includes a majority of the shareholders who are not controlling shareholders of the company and do not have a "Personal Interest" (as defined in the Companies Law- generally any personal benefit, gain or other interest derived by the shareholder (or a relative or related entity) from approving an act or transaction) in the approval of the respective resolution who participate in the vote (abstentions not taken into account) or (b) the total number of votes of the shareholders referred to in (a) above that are voted against the proposed resolution does not exceed two percent (2%) of the company's total voting rights.

Local Israeli issuers have historically been characterized by the presence of controlling or significant shareholders (around 75% of companies in the TA-125), where "control" or "control block" can refer to the largest shareholder or shareholder group with at least 25% of voting rights or rights to appoint the CEO or a majority of the board of directors. As such, when we refer to non-controlled companies, our intention is to indicate public issuers without a significant shareholder with at least 25% of voting power, in line with Israeli market practice.

In formulating our submission, we reviewed and benefitted from certain third party sources and commentators, including a Position Paper (Hebrew) published in March 2019 by Entropy Corporate Governance, part of Entropy Group, which supplies proxy advisory and corporate governance services to the local market in Israel, and whose policy positions are generally regarded within Israel as a benchmark for governance best practices. While we do not agree with Entropy on every point, we recognise that their positions are relevant in the context of discussing Israeli best practice.

We generally support Entropy's position on how boards at non-controlled companies might develop an operational framework as well as develop a smooth working relationship with the general body of shareholders. In particular, we support Entropy's recommendation to the effect that shareholders and companies make efforts to promote and maintain regular dialogue in order to build and maintain trust, show commitment to transparency and thus prevent friction that can occasionally occur during crucial points of decision-making, such as at an annual or special general meeting of shareholders. That being said, we view investor participation at general meetings as an intrinsic part of such ongoing dialogue, irrespective of direction of vote cast, and we would urge companies and their boards not to view votes against board resolutions as inherently antagonistic.

Our position is informed by over a decade of experience analysing corporate governance at Israeli companies as well as extensive engagement with Israeli issuers, which we actively pursue solely to increase mutual understanding. Finally, given our experience analysing best practices globally for the world's largest global institutional investors, we base our suggestions in this paper not only on existing laws and recommendations under the Companies Law but also on our experience with corporate governance practices advocated by institutional investors in other developed markets. Many of our suggestions, although offered specifically in relation to governance rules for non-controlled companies, could apply equally well to all public companies. For more information on our publicly availably Israeli and global policy guidelines and issuer engagement policy, please refer to www.glasslewis.com/guidelines.

Provisions that we suggest adapting for non-controlled companies

Code for Best Practice Recommendations; "Comply or Explain" Approach

Israel does not have a corporate governance code. Instead, best practice recommendations for boards in Israel were set by the First Addendum of the Companies Law, which recommend practices that may be incorporated by companies in their articles of association. The recommended rules in the First Addendum include, among others, a recommendation that boards of non-controlled companies comprise a majority of independent directors. However, Israeli companies typically do not disclose beyond the minimum legal requirements on application of non-binding corporate governance "best practices".

In this regard, we believe that Israeli companies and their dispersed shareholders could benefit from either an update or renewal of the First Addendum or the formulation of a distinct code in a similar style to the UK Corporate Governance Code with a "comply or explain" approach. The "comply or explain" system's benefit is that it lets the market decide; rather than setting out binding laws, this may allow a broad combination of different stakeholders in the Israeli market to contribute to and coalesce around an accepted set of best practice principles.

Where such agreed standards are deemed inappropriate for individual companies, the latter would be able to explain their approach. While at controlled companies a company's overall management, strategy, board oversight regime and governance culture may have been accepted as inevitably subject to the direction dictated by the controlling shareholder, at non-controlled companies the chief agency problem threatening the value of dispersed public shareholders is ordinarily derived from executive management.

Key Takeaway: The board's role in smoothly complementing yet overseeing the work of senior management on behalf of shareholders is arguably best consolidated by boards recognizing a generally accepted best practice framework as a roadmap to sound governance, while charting their own course in relation to such framework in a manner coherent with an individual company's situation. As such, we would support an update and

rejuvenation of the First Addendum or the formulation of a distinct corporate governance code utilizing a "comply or explain" approach.

Codify the position of a nominating / corporate governance committee

Director nominations at controlled companies in Israel have typically been made without detailed explanation as to the rationale behind a nomination, the strengths and qualifications of the nominee, the overall board strategy on its own composition and succession planning. The absence of such disclosure makes it difficult for institutional investors—particularly those located abroad who might not personally know the individuals—to understand which director nominees would best serve their interests.

The same shortfalls apply in a majority of instances for the election of external directors who, while needing to meet strict independence standards and requiring Disinterested Majority support, are generally assumed in most cases to be the preferred candidate of the controlling shareholder (see Glass Lewis' past commentary on the issue).

As such, in the absence of a dominant shareholder, the board's role in recommending to shareholders its own potential members acquires an extra layer of significance. We believe the learned experience of numerous markets and regulatory regimes has led to the formation at board level of a nominating committee becoming the best practice standard for ensuring an independently overseen, professional and clearly reasoned director nomination procedure at non-controlled public companies. Since the crucial task of nominating directors necessitates a periodic and holistic appraisal of a company's governance in a range of aspects, it has become common in developed markets to unite the tasks of nominating directors and ensuring sound adherence to governance principles under the single banner of a "nominating and corporate governance committee".

The nominating and governance committee, in our view, should be the agent for shareholders responsible for the board's governance of the company and its executives. In performing this role, it is responsible and accountable for the selection of objective and competent directors. It is also responsible for providing leadership on governance policies adopted by the company. In addition, and particularly relevant for modern day challenges relating to environmental and social (E&S) oversight, such a committee may in future also be entrusted with overseeing a company's management of its E&S priorities and corporate responsibility initiatives or reporting.

Until now, a handful of Israeli public company boards, including issuers with and without a controlling shareholder, have voluntarily led the way in attempting to formalise a director nomination process that details the rationale behind nominations and attempts to obtain minority and institutional shareholder trust through sound procedure and strong disclosure. Such procedures have included:

- Convening a special (nominating) committee comprising a majority of external directors;

- Tasking this special committee with recommending to the board an optimum mix and composition of directors, taking into account the shareholder landscape and proposing nominees to serve as director;
- Tasking this committee with contacting shareholders and/or their representatives in order to give rise to an orderly procedure for identifying director candidates in coordination with shareholders, so that the list of candidates would be suitable and representative of a company's shareholders; and
- Retaining an external and independent adviser to assist the special nominating committee in identifying directors.

Ultimately, the nominating committee should recommend the adoption of a board composition policy which considers the appropriate size of the board, appropriate representation of shareholders, required professional experience and skills of board members, proportion of independent and external directors, diversity of the board in terms of age, gender and professional background, and also characteristics of board chair and the means of his/her selection.

In our view, the above represents an example of a strong procedure for nominating directors, particularly at times of significant board refreshment.

Key Takeaway: Glass Lewis supports the codification of corporate governance rules governing the establishment, function, work procedure and composition of a board-level committee entrusted with nominating director candidates to serve on the board.

Disclosure of Detailed Voting Results

Currently, most Israeli public companies do not disclose detailed results of shareholder votes taken on ordinary general meeting resolutions, although disclosure of items requiring a Disinterested Majority of shareholders is broken down in detail, including the percentage of shareholders classed as "disinterested" who vote against a proposal and their overall percentage weight in the entire population of shareholders.

We support the publication of detailed voting results on all general meeting resolutions, whether routine or extraordinary.

Non-disclosure of detailed voting results prevents shareholders from assessing significant opposition to specific resolutions, even if they could typically be deemed routine items. While the vast majority of board-proposed general meeting resolutions in Israel are approved by shareholders, substantial opposition generally indicates an issue noteworthy of action on the part of the board. We believe that shareholders benefit greatly from having access to such information following the meeting so they can assess the position of other shareholders and the appropriateness of the board's response to controversial topics. The absence of such information makes it difficult for shareholders to exercise their stewardship duties effectively and compounds agency problems.

Key Takeaway: We believe that any update to legal provisions and recommendations regarding adapting corporate governance standards should consider the matter of voting

results on ordinary resolutions at shareholder meetings and ideally instate a requirement to disclose a detailed breakdown of vote results on all agenda items.

Provisions that are adequate for controlled and non-controlled regimes alike

Key Board Committees: Function and Composition

Current Israeli Companies Law clearly designates minimum standards for the function and composition of key board committees, specifically the audit, financial statements review and compensation committees. These minimum legal standards include requirements that a majority of such committees' members, including the committee chair, be external (independent) directors.

Due to these requirements, these committees often contain identical members and are united into one all-purpose committee which sits in these different functions. These committees have a key role in overseeing internal and external auditing of financial statements, approving financial statements, approving significant and related party transactions and approving compensation policies and agreements.

Key Takeaway: We believe the current rules in regard to these committees continue to provide adequate safeguards for shareholders and we do not recommend making any substantial alterations to the present legal provisions.

Election procedure for external directors

The Companies Law requires that candidates nominated to serve as an external (independent director under Israeli law) receive Disinterested Majority shareholder approval in order to be elected. Upon appointment, such directors must be independent of the company's controlling shareholders for the last two years, or in the absence of a controlling shareholder, may not have a business relationship with the company's chair, CEO, significant shareholder, or senior financial officers.

Other existing legal safeguards include: external directors must serve a three-year term and may be re-elected no more than twice (i.e. three three-year terms), except for directors at foreign-listed Israeli companies. These strict independence and appointment/removal criteria are designed to ensure external directors can act more freely to ensure board oversight of sensitive items of business and executive compensation without necessarily fearing risk of removal on an annual basis.

Key Takeaway: We believe the current rules in regard to external director appointments provide adequate safeguards for shareholders in a non-controlled corporate setting, particularly given Israeli norms for appointing an active and non-independent board chair (see below). As such, we do not recommend making any substantial alterations to the present legal provisions.

Chair of the Board at a Non-Controlled Company

In general, Glass Lewis believes that separating the roles of corporate officer and chair creates a better governance structure than a combined executive/chair position. An executive manages the business according to a course the board charts. Executives should report to the board regarding their performance in achieving goals the board sets.

In Israel, it is extremely uncommon for the CEO to serve as chair and shareholders must approve such simultaneous service. The chair of the board is elected by board members from among their number. Chairs in Israel are commonly retained on an 'active' basis (the term "active" in Israel implies that chair duties extend beyond leading board meetings and may be seen as synonym for "executive" chair in other markets), and even 'non-active' chairs are also generally not considered independent of a company and may not serve on key board committees.

Key Takeaway: In our governance voting policies for other developed markets, when a company has not separated the positions of chair and CEO or has installed a non-independent chair, we generally believe the presence of a lead independent director or vice chair can serve to ensure appropriate oversight of any potential conflicts of interest that may affect the performance of the board.

While we would support governance recommendations giving treatment to different methods of carrying out board leadership, we would prefer a system that allows for individual companies' discretion on the matter. One approach we believe could be favourable in the Israeli market is a distinction between whether an appointed chair is independent "on appointment", as described under the UK Code (Provision 9), where companies would be required to explain the rationale behind an appointed chair who was not considered independent upon appointment. Finally, a majority independent board containing external directors, choosing from their number the chair they deem most suitable, would appear to us to be a reliable way of ensuring the appointment is carried out in a professional manner beneficial to all shareholders.

Approval procedure for certain business and compensation matters

The Companies Law requires that certain transactions, actions and arrangements, mainly with related parties including the CEO, directors and controlling shareholders and affiliates thereof, be approved by the audit committee or compensation committee (as applicable), by the board of directors and finally with Disinterested Majority shareholder approval.

Key Takeaway: We believe the current rules would continue to provide adequate safeguards for shareholders of non-controlled companies by way of enabling them to cast a vote on the agenda item, and as such we do not recommend making any substantial alterations to the present legal provisions.

Concluding Statement

In summary, we believe that the existing Israeli legal and regulatory frameworks, as well as the generally high level of involvement from local market participants and institutional investors, contribute to the Israeli corporate landscape providing strong protections to shareholders of all kinds, including dispersed and minority shareholders. At the same time, Israel has been and continues to be the launchpad for numerous public market successes, including many non-controlled companies from inception and those that have listed on foreign stock exchanges, backed by a vocal but generally supportive shareholder base.

We believe the framework provided by Companies and Securities Laws, although clearly crafted to contend with the corporate dynamic created at companies with large dominant or controlling shareholders and a dispersed institutional shareholder minority float, continues to offer a robust procedural basis for sound corporate decision-making and shareholder participation on salient governance and executive compensation matters.

In our view, some of the proposed enhancements to governance practices discussed above would enhance investor stewardship and mitigate conflicts of interest. However, wholesale reform of an otherwise relatively functioning system may not be necessary.

Thank you in advance for your consideration and please do not hesitate to contact us if you would like to discuss any aspect of our submission in more detail.

Respectfully submitted

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